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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1366

ROBERT AND SANDRA SCHAEFER, ET AL.,
Petitioners,

vs.

FIRST NATIONAL BANK OF LINCOLNWOOD, ET AL.,
Respondents.

ANSWER TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT COURT.

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ANSWER TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT COURT.

Respondent, Rodman & Renshaw, respectfully submits that the Petition for Writ of Certiorari filed by Robert and Sandra Schaefer, et al., is wholly without merit and prays that the Petition be denied.

QUESTION PRESENTED.

The question as presented by petitioners does not reflect the issues requiring favorable answers in order for petitioners to prevail.

Fairly put, the first question should be whether or not facts descriptive of a fraudulent manipulation of the price of shares of stock state a cause of action under Section 1 of the Sherman Act.

Only if this first question is answered affirmatively is the question posed by the case reached, i.e. whether or not conduct specifically actionable under the Securities Act is also actionable under the anti-trust laws.

STATEMENT OF THE CASE.

The Petition here seeks review of a decision of the trial court, dismissing, on motion, one count of a three count civil complaint, a dismissal which was affirmed by the Seventh Circuit Court of Appeals.

Petitioners' statement of the case, however, is not drawn from their pleading but appears to be an inaccurate review of the criminal case brought by the government, larded with matters that are not a part of this record.

What is reflected in this record is that Petitioners, in the first count of their complaint, sought recovery under every possibly applicable section of the Securities Act of 1933, the Securities and Exchange Act of 1934, and Rule 10(b)5 promulgated by the Securities and Exchange Commission for a fraudulent manipulation of the price of the stock of Hercules-Galion Products, Inc. (Hercules), a stock listed on the American Stock Exchange.

This manipulation as described in Count I, was accomplished by bribing representatives of the brokerage houses to induce customers to purchase Hercules, by purchases made by the conspirators themselves, and by timing of the purchases, all as stated in the pleading "creating actual and apparent trading in such security, and raising the price of such security, for the purpose of inducing the purchase of such security by others."

This same conduct was realleged and incorporated in Count II as a violation of Section 1 of the Sherman Act.

The statements as to the purpose of maintenance of the inflated price for merger purposes and the attempted merger (Petition pp. 6, 7) are not part of the pleading sought to be sustained and are not found in this record.

In the trial court, Judge Decker, whose opinion is included herein as Appendix A, found "there is no dispute that the market rigging scheme alleged in the complaint is completely encompassed within the proscriptions of Section 9 of the Act" (Appendix A, p. A3). (The reference is, in context, to Section 9 of the Securities Exchange Act of 1934.)

In the Court of Appeals, in the context of deciding whether the action could be maintained under Rule 10(b)5 *and* Section 9, Judge Sprecher stated that the conduct fell "squarely within section 9(a)2." (Petition, Appendix 13a.) Judge Fairchild, concurring, with reference to the antitrust count, declared the conduct as "the manipulation specifically described in § 9(a)(2)." (Petitioners' Appendix p. 28a.)

The Court of Appeals sustained Judge Decker for the reasons stated in his opinion and for the expressed reasons that petitioners had a full and complete remedy for a scheme "envisioned to be fully dealt with under the securities acts." (Petitioners' Appendix 28a.)

Judge Fairchild believed (Petitioners' Appendix p. 29a) that the later enactment, § 9(a)(2) of the 1934 Act, was an implied amendment of the Sherman Act *if* the conduct fell within the scope of the antitrust laws or a recognition that the activity had not previously been prohibited by the Sherman Act.

This Respondent has also filed a petition for certiorari seeking review of the Court of Appeals' holding, *inter alia*, that an action for which a specific remedy is granted under Section 9(a)(2) of the 1934 Act may also be implied and maintained under Section 10(b) of that Act, the Commission's Rule 10(b)5 promulgated pursuant to Section 10(b) and Section 17 of the 1933 Act. Respondent's petition was docketed May 29, 1975, as No. 74-1407.

REASONS FOR DENYING THE WRIT.

Legislative history and past precedent deny the claimed right of action under the Sherman Act for market manipulation. The issue sought to be imposed upon this Court by petitioners is stated as the "very narrow but important overlap" of anti-trust and securities acts remedies. (Petition, p. 9.)

As framed by the present case, the issue is so narrow that it has escaped the attention of anti-trust lawyers for the better part of a century and securities lawyers for some two score years. It is not difficult to discover the reasons for such oversight. Additional reasons, if necessary, abound in the petition itself.

I.

THE SECURITIES ACTS, AND SECTION 9(a)(2) OF THE SECURITIES EXCHANGE ACT OF 1934 IN PARTICULAR, WERE INTENDED TO AND DID FILL A REGULATORY VOID.

Petitioners' arguments do not attempt to explain the gap in antecedent authority supporting their theories since the passage of the Sherman Act and the Securities Acts. The obvious explanation for this gap is that a fraudulent price is not a fixed price as the latter term is thought of or used in anti-trust terminology. This obvious explanation is also the correct explanation as is demonstrable from the history of the Securities Acts and from the anti-trust background.

If investors injured in consequence of market manipulations already had a right of action under the Sherman Act, then Congress engaged in a useless act in passing § 9, and, indeed, § 17(a) and Rule 10b-5—if they also apply to market manipulation—since the remedy afforded by the Sherman Act is more liberal in its damage provisions and not subject to various limitations found in § 9 and the other two sections as well.

The fact of the matter is that the 1934 Act, and § 9 in particular, was passed because nobody, in or outside of Congress, believed that a person injured through market manipulation had any *federal* right of action on account of his injuries. Indeed, the explicit purpose of the 1934 Act was to fill a federal void and create a federal cause of action for market manipulation precisely because it was thought there was no existing federal civil remedy. To put the matter another way, it was believed that the only civil remedies then exisiting were under either the anti-fraud provisions of state Blue Sky laws or common law doctrines of fraud in the various states. No one in Congress thought it was engaging in a useless or superfluous act in passing § 9 by giving an alternative, but much weaker, remedy than already existed under the Sherman Act.

In Loss, Securities Regulations, Vol. 3 p. 1549 (2d Ed. 1961) it is stated:

> "The object of § 9(a)(2)—which the Commission has termed 'the very heart of the act'—is to outlaw not only pool operations but 'every other device used to persuade the public that activity in a security is the reflection of a genuine demand instead of a mirage."

How could § 9(a)(2) possibly be the "heart" of the 1934 Act if all that it did was to give a more restricted single-damage remedy in addition to an existing treble damage remedy under the Sherman Act

Congress certainly thought it was passing § 9 in order to give a person injured by market manipulation *a federal statutory remedy that he did not then have*. This is made abundantly clear by the Committee reports and debates in Congress.

What finally became the Securities Exchange Act of 1934 was H. R. 9323. H. R. 1383 (73rd Cong., 2d Sess., 1934); The Home Report accompanying this bill, in referring to § 9, states:

> "To insure to the multitude of investors the maintenance of fair and honest markets, manipulative practices of all

kinds on national exchanges are banned * * *. *To make effective the prohibitions against manipulation civil redress is given to those able to prove actual damages from any of the prohibited practices.*" (Emphasis supplied.)

The Congressional Record is replete with statements by Congressmen stressing the necessity of passing § 9 in order to give injured investors a federal cause of action for injuries suffered in consequence of market manipulation. A few examples are given below.

At 78 Cong. Rec. 7717, Representative Ford from California said:

> "But if he [the investor] is sheared like a lamb through a rigged market, through manipulations resulting from wash sales and matched orders he has a legitimate cause for complaint, and it is his Government's business through its legislative and executive branches, to throw about this stock-purchasing and stock-selling business such safeguards as will make these trading devices, so long indulged in, *impossible in the future.*" (Emphasis supplied.)

At p. 7862, Representative Lea of California said:

> "This bill is severe in its denunciation and penalties for manipulative violations of the law. It not only prescribes criminal penalties for those who engage in these manipulative practices, but it also gives a civil suit in behalf of a man who is the victim of such practices. *It is going to be dangerous for a man to engage in window dressing fraudulent and deceptive methods for the purpose of defrauding investors.*" (Emphasis supplied.)

Representative Wolverton of New Jersey, at p. 7865, stated:

> *"The need for regulation of stock exchanges* and corporate securities having the benefit of the nationwide facilities afforded by such exchanges was revealed, if not already known by the recent investigation conducted by the Senate Committee on Banking and Currency. Manipulative price control methods were found to be practiced by corporate officers and others who utilized the stock exchange facilities to advance their nefarious and unconscionable schemes." (Emphasis supplied.)

The Representative, after referring to what eventually became § 9 (then § 8), said:

> "And, in addition to the declaration of criminal responsibility, there is also civil liability in favor of any person injured by any transaction. *If anyone should desire to observe a real genuine set of legislative teeth, he can do so by giving consideration to Section 8 of this Act.*" (Emphasis supplied.)

Petitioners' position is that Congress, in passing § 9, was not enacting legislative teeth on behalf of persons injured by market manipulation, but in fact was engaged in pulling teeth.

Again, Representative Mahoney of Connecticut said at p. 7869:

> "This bill is primarily *designed to prevent a manipulation of securities* * * *
>
> "Manipulative and misleading statements *to be hereafter forbidden by law* . . ." (Emphasis supplied.)

Representative Mapes of Michigan said at p. 7922:

> "The second main objective of the bill is to provide the owner in corporate securities traded in and upon our national stock exchanges and other investors, a fair and honest market place in which to buy and sell corporate securities * * *. It is to help them to maintain a fair and honest market price and open market, where the prices operated on the exchanges will represent as nearly as may be the value of the securities that are listed, uninfluenced by manipulative practices and evils which everyone condemns * * *"

The Senate version of the 1934 Securities Exchange Act was S. B. 3420. § 9 of the Senate version prohibited manipulation of security prices. Senator Fletcher, at p. 8163, in discussing this section, stated:

> *"We propose * * * to outlaw manipulation* and unfair practices and combinations by which to exploit the public and misrepresent values, such as pools, wash sales, fictitious transactions, and the like * * *" (Emphasis supplied.)

The Senator, after referring to the English decision of *Scott* v. *Brown*, 2 Q. B. 724 (1892), holding wash sales to be a fraud on the public, said at p. 8165:

> "The practice referred to appears to be unfair, unjust and really fraudulent, misleading the investing public. *We endeavor to stop it by this measure.*" (Emphasis supplied.)

Further examples might be multiplied. The ones given are sufficient to show that Congress, in passing § 9, felt it was outlawing a practice, *which federal law did not then outlaw* and was giving a civil remedy for market manipulation where none had existed previously. It bears repetition to say that, if market manipulation was in fact then actionable under the Sherman Act, § 9 (and § 17 of the 1933 Act and Rule 10b-5, to the extent they might apply to market manipulations) are completely useless pieces of law.

II.

MARKET MANIPULATION DOES NOT CONSTITUTE A RESTRAINT OF TRADE UNDER THE SHERMAN ACT.

If a fraudulent price is not a fixed price, no violation of the Sherman Act has been alleged and it is unnecessary to consider the problems of statutory construction or statutory accommodation which would then be presented.

It was settled law that manipulation of prices in the securities market constituted a fraud and not a restraint of trade at common law. *Barrett & Co.*, 9 S. E. C. 319; *Halsey, Stuart & Co., Inc.*, 30 S. E. C. 106, Meyer, *Law of Stock Brokers and Stock Exchanges* (1936 Supp.), pp. 84-86; Berle, *Stock Market Manipulation*, 38 Columbia Law Review 393; Berle, *Liability for Stock Market Manipulation*, 31 Columbia Law Review 264; *United States* v. *Brown*, 5 F. Supp. 81 (S. D. N. Y. 1933), *aff'd* 79 F. 2d 321 (2nd Cir. 1935); *Harper* v. *Crenshaw*, 82 F. 2d 845, *cert. den.* 298 U. S. 685 (1936). See, also, Annotation in 115 A. L. R. 271 entitled "Market Manipulation of Securities."

United States v. *Brown*, 5 F. Supp. 81 (S. D. N. Y. 1933), *aff'd* 79 F. 2d 321 (2nd Cir. 1935)[1], described why manipulation of the market was regarded as a species of common law fraud. There the court said at p. 85:

> "When an outsider, a member of the public, reads the price quotations of a stock listed on an exchange, he is justified in supposing that the quoted price is an appraisal of the value of that stock due to a series of actual sales between various persons dealing at arm's length in a free and open market on the exchange, and so represents a true chancering of the market value of that stock thereon under the process of attrition due to supply operating against demand. Cf. Northern American Telegraph Company v. Northern Pacific Railway Company (C. C. A.) 254 F. 417, 418.
>
> "If, however, the market for the stock listed on an exchange is a manipulated or controlled market, in which a group of insiders, in order to enable themselves profitably to dispose of their holdings, are artificially raising the quoted price of the stock on the only market to which any man who wishes to purchase that stock would inevitably resort, and an outsider buys in that market he obviously pays more—how much more perhaps cannot be estimated and, in any event, in a criminal case of this kind, is not material—than he would have paid in a free and open market, and hence is a victim of unfair dealing by the insiders. But he is entitled to a fair dealing and should get it. Wilson v. United States, 190 F. 427, 433, 434 (C. C. A. 2); Looker v. United States, 240 F. 932, 933-935 (C. C. A. 2)."

All of the foregoing properly demonstrates that the securities acts generally and § 9(a)(2) of the 1934 Act in particular, were enacted to prohibit that which was unregulated by any federal statute including the Sherman Act.

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1. This case involved a fraudulent manipulation of a stock listed on the New York Stock Exchange and was brought under federal laws prohibiting the use of mails to defraud. Had the Sherman Act been thought to be applicable, it would have been unnecessary to proceed on the mail fraud charge.

III.

THE CLAIMED CONFLICTS ARE NONEXISTENT.

A.

This Court's Decisions.

Petitioners claim that the decision appealed from, "in distinguishing" the case of *United States* v. *Patten*, 226 U. S. 525 (1912), "misinterpreted, misconstrued and misapplied" that decision. The fact is that the case was not mentioned in the Court of Appeals' opinion.

There, the court considered the applicability of § 1 of the Sherman Act to an alleged criminal conspiracy to *corner* the market in cotton. A market corner, it was agreed (page 539), "consists * * * in acquiring control of all or the dominant portion of a commodity, with the purpose of artificially enhancing the price." One of the important features of a corner is to "purchase for future delivery" and "withhold from sale for a limited time." Despite the wealth of other detail, the amended complaint herein fails to describe the fraudulent transactions in a manner reaching this definition.[2]

It was against the contention that § 1 of the Sherman Act reached only agreements among competitors involved in interstate commerce to suppress competition among themselves that *Standard Oil* v. *United States*, 221 U. S. 1, 59 (1910) was quoted in *Patten*. The sum total of *Standard Oil* and of *Patten* as applicable here is that the anti-trust acts prohibit and punish

2. It is difficult to conceive a "corner" in the stock of a corporation. In the case of a commodity such as cotton, commercial necessities insure a continuing demand, enhancing price as a "corner" refuses to sell. A "corner" in corporate shares could be operative in the same manner only if, at the time, a "short" position obtained of meaningful magnitude. Apart from that situation, shares of stock of one corporation compete generally with innumerable other types of investment.

monopoly prices. *Standard Oil* made clear that the enchancement of prices due to monopoly was the evil at which the Sherman Act was directed. Speaking of the English decisions, Justice White (p. 57) noted "it came * * * to pass that contracts or acts which it was considered had a monopolistic tendency, especially those which were thought to unduly diminish competition and hence to enhance prices * * * came also in a generic sense to be spoken of * * * as being in restraint of trade."

The corner in the cotton market in *Patten* was designed to effect a monopoly price, not a fraudulent price. The agreement among those involved in the "corner" not to sell, enhanced prices in exactly the same way that a monopolist controlling a commodity with an assured demand, could. Nothing, it is repeated, in the amended complaint attributes to the alleged conspirators control of all or a dominant portion of the market for the stock of Hercules-Galion. Instead, the complaint charges simple roguery as the means of enhancing the price.

Petitioners also cite *Board of Trade of Chicago* v. *Olsen*, 262 U. S. 1 (1922) in support of their argument. It is submitted that, had the Sherman Act prohibited fraudulent manipulation of futures, there would have been no Grain Futures Act of 1922 and the case would not have been brought. Petitioners' further citation of *Cargill, Inc.* v. *Board of Trade*, 164 F. 2d 820 (7 Cir. 1947) is inapplicable to anything here involved.

In *Apex Hosiery Co.* v. *Leader*, 310 U. S. 469, 495 (1939) the Court, in an extended discussion of the types of acts which constitute restraints of trade in contemplation of the antitrust laws, pointed out that the term "restraint of trade" in the antitrust laws is to be given the meaning which the phrase had at common law. See, also, *Standard Oil* v. *United States*, 221 U. S. 1 (1910), *Schatte* v. *International Alliance*, 182 F. 2d 158, 159 (9th Cir. 1950); *U. S.* v. *Greater Kansas City Chapter, et al.*, 82 F. Supp. 147, 149 (W. D. Mo. 1949). In other words, "[The Sherman Act] does not purport to afford remedies for all torts committed by or against persons engaged in inter-

state commerce." *Hunt* v. *Crumboch,* 325 U. S. 821, 826 (1944). Since a conspiracy to manipulate the market had never been held a combination in restraint of trade, it cannot be deemed a conspiracy to restrain trade within the meaning of § 1 of the Sherman Act.

B.

The Alleged Circuit Court of Appeal Conflict.

The only case cited in support of the claim of conflict between circuits is *S. S. W., Inc.* v. *Transport Association of America,* 191 F. 2d 658 (D. C. Cir. 1951). Petitioners again claim the Court of Appeals here "misinterprets" the decision. The Court here did not mention, rely on, or interpret the case.

In any event, there is no conflict in the instant decision and the *S. S. W.* case. *S. S. W.* dealt with conduct subject to regulation by the Civil Aeronautics Act, 49 U. S. C. A. § 401 *et seq.,* which the Court stated (p. 662) "covers the dominant facts alleged in the present case as constituting a violation of the Anti-Trust Act." The Court emphasized that the Civil Aeronautics Act did *not* authorize an award of damages and noted in accordance with the Seventh Circuit here, "Where specific damage provisions are contained in regulatory statutes, it has been held that there may be no recovery of double damages under the Anti-Trust laws" (Page 663.)

Petitioners discern a resemblance between the cases because of the lack of specific damage provisions in Section 17 of the 1933 and Section 10(b) of the 1934 Act. Yet, petitioners assert that these same sections are "the primary bases for Count I here." (Petition p. 17.) It would appear that the governing consideration is whether *any* damage remedy is available and this is the view reflected in Judge Decker's opinion. (Appendix pp. 5-6.)

C.

Judge Decker's Decision.

Petitioners attack the trial court's decision as being in conflict with decisions in other circuits in its holding that punitive damages may not be recovered under common law counts for conduct covered by the Securities Act. In the context of this case, Judge Decker's opinion was eminently correct.

The Schaefers, the named petitioners here, had been paid approximately twice their out of pocket expenses by some defendants in return for an agreement not to execute any judgment obtained in the case against those making the payments. This deal was made without the knowledge of other defendants. When it became known, a motion to dismiss the Schaefers was made, based upon this payment. The motion was resisted on the ground, among others, that their asserted right to punitive damages under the common law count permitted their continued presence in the litigation.

Judge Decker's opinion dismissing the Schaefers, on these facts, was eminently correct.

CONCLUSION.

The Petition here reflects a simplistic view of matters with a long and intricate legal history. The determined sophistry with which petitioners' argument is advanced must yield to that history. Petitioners are not latter day discoverers of a treble damage bonanza, overlooked by others before them.

The Petition should be denied.

Respectfully submitted,

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APPENDIX A.

IN THE UNITED STATES DISTRICT COURT,
For the Northern District of Illinois
Eastern Division.

ROBERT SCHAEFER, ET AL.,
Plaintiffs,
vs.
THE FIRST NATIONAL BANK OF LINCOLNWOOD, ET AL.,
Defendants.
No. 69 C 364

MEMORANDUM OPINION.

This is an action brought by purchasers of the stock of Hercules Galion Products, Inc. to recover damages for defendants' alleged conspiracy to manipulate the market for such stock. The complaint to manipulate the market for such stock. The complaint names stockbrokerage firms, their employees, and certain other individuals and corporations, alleging a detailed scheme whereby defendants are said to have created an artificially active market for Hercules Galion stock in order to raise its price so that certain defendants could sell their holdings at a profit. The complaint, brought as a class action, contains counts based on the securities laws, the antitrust laws, and the doctrine of common law fraud.

A number of motions to dismiss have been filed. Those of general applicability will be considered first; then those relating to specific defendants or plaintiffs will be discussed.

Count 1—the Securities Acts.

Count 1 of the complaint states that defendants have violated sections 9, 10 and 15(c) of the Securities Exchange Act of 1934 and sections 12(2) and 17 of the Securities Act of 1933. Section 9 of the 1934 Act and section 12(2) of the 1933 Act have their own express limitations periods, while the other cited sections have none. Actions brought pursuant to section 9 must be commenced "within one year after discovery of the facts constituting the violation and within three years after such violation," (§ 9(e)). Actions pursuant to section 12(2) must be brought within one year after discovery of the untrue statement or omission, or after it should have been discovered, and within three years after the sale (§ 13 of the 1933 Act). The five year Illinois statute of limitations for fraud (83 Ill. Rev. Stat. § 16) applies, however, to actions brought under § 17 of the 1933 Act and § 10(b) of the 1934 Act. *Morgan* v. *Koch*, ... F. 2d ..... (7th Cir. 1969, No. 17447); *Northern Trust Company* v. *Essaness Theaters Corporation*, 103 F. Supp. 954 (N. D. Ill. 1952); *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951).[1]

Many of the defendants in this cause were indicted for their alleged activity by a federal grand jury in New York in August, 1967. Because the complaint in this action was not filed until February, 1969, defendants contend that the action was commenced more than one year after discovery of the violation. They further argue that, since the alleged scheme falls within the prohibitions of § 9 and § 12(2), the other provisions of the Acts should not apply and therefore the one year time bar applicable to § 9 and § 12(2) requires dismissal of count 1.

1. Defendants argue that these and other cases applying state statutes of limitations are not well reasoned and should be disregarded in favor of application of one of the limitations provisions found in the Securities Acts. The doctrine of borrowing state limitations statutes is firmly entrenched in this and other Circuits, and for that reason is not open for consideration by this court. See 3 Loss, *Securities Regulation*, pp. 171 *et seq.*

Defendants' argument is logically persuasive. There is no dispute about their claim that the market rigging scheme alleged in the complaint is completely encompassed within the proscriptions of section 9 of the 1934 Act. To hold that the more expansive provisions of section 10(b) or section 17 apply, with their longer statutes of limitations, is to ignore the express limitations incorporated in the Act. And it assumes that the carefully inserted time limitation in section 9(e) was repealed, *sub silentio*, by passage of section 10(b) of the same Act, or was rendered meaningless *ab initio* by prior passage of the 1933 Act. Furthermore, it ignores the rationale of implied remedies under the Securities Acts enunciated in *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964), where the Court made it clear that remedies were to be created "when necessary to make effective the congressional purpose." 377 U. S. at 433. When the congressional purpose has been congressionally implemented by statutory creation of remedies, as it was in §§ 9 and 12(2), the need for judicial implementation of its purpose is certainly diminished.

Despite these misgivings, however, I am constrained to hold that plaintiffs may maintain this action pursuant to section 10 (b), Rule 10b-5, and section 17. Such a holding is dictated by the decision of this Circuit's Court of Appeals in *Jordan Building Corporation* v. *Doyle, O'Connor & Co.*, 401 F. 2d 47 (7th Cir. 1968). The plaintiffs in that action sued brokerage houses, their employees, and the issuing corporation claiming that defendants fraudulently induced them to purchase certain debentures. The District Court dismissed count 1, which was premised on a violation of Rule 10b-5, because of its conclusion that the allegations of the complaint fell squarely within the prohibitions of § 12(2) of the 1933 Act. On appeal, the defendants also argued that § 15(c)(1) of the 1934 Act controlled and barred suit under Rule 10b-5. In its reversal, the Court of Appeals rejected these arguments, concluding that "the remedies supplied by and under these acts are cumulative and not mutually exclusive." 401 F. 2d at 51.

No meaningful distinction appears between the *Jordan* case and the instant action. The board and virtually unlimited role which the Court there assigned to Rule 10b-5 has equal applicability here. Accordingly, plaintiffs are not limited to the provisions of § 9 or § 12(2), but may also bring this action pursuant to § 17 of the 1933 Act and §§ 10 and 15(c) of the 1934 Act. The motions to dismiss count 1 in its entirety because of the short statutes of limitations applicable to §§ 9 and 12(2) must therefore be denied. See also *Klein* v. *Spear, Leeds, Kellogg, et al.* (S. D. N. Y. 1969), CCH, Fed. Sec. L. Reports, ¶ 92,454; *Osborne* v. *Mallory*, 86 F. Supp. 869 (S. D. N. Y. 1949); *Acker* v. *Schulte*, 74 F. Supp. 683 (S. D. N. Y. 1947).

Nor can this court conclude on the record before it that references to §§ 9 and 12(2) must be stricken from the complaint as barred by the short statutes of limitations. Defendants have filed extracts from the depositions of certain plaintiffs which indicate that they had knowledge of the criminal indictment soon after it was returned, and more than one year before the complaint was filed. These are, of course, not properly before the court on motions to dismiss. And plaintiffs should have a chance to rebut them by submitting evidentiary material. Defendants' motions to dismiss directed to this aspect of count 1 are therefore denied without prejudice to reassertion of the same issue by motion for summary judgment.

Count 2—The Sherman Act.

In count 2 of the complaint plaintiffs reallege most of the allegations of count 1 and claim that defendants have violated section 1 of the Sherman Act, 15 U. S. C. 1. No cases have been found which discuss the applicability of the anti-trust laws to securities market rigging schemes. For reasons to be stated, I have concluded that count 2 fails to state a cause of action.

As previously noted, section 9 of the 1934 Act expressly prohibits the type of stock market manipulation here alleged.

The Sherman Act's prohibition, on the other hand, is addressed more generally to contracts, combinations and conspiracies "in restraint of trade or commerce." As stated in *Montague* v. *Electronic Corporation of America*, 76 F. Supp. 933, 936 (S. D. N. Y. 1948), involving an apparent overlap of remedies under section 10(b) of the 1934 Act:

> "The settled rule of statutory construction is that, where there is a special statutory provision affording a remedy for particular specific cases and where there is also a general provision which is comprehensive enough to include what is embraced in the former, the special provision will prevail over the general provision, and the latter will be held to apply only to such cases as are not within the former. *United States* v. *Chase*, 135 U. S. 255, 260 . . .; *Ex Parte United States*, 226 U. S. 420, 424 . . .; *Kepner* v. *United States*, 195 U. S. 100, 125 . . .; *D. Ginsberg & Sons, Inc.* v. *Popkin*, 285 U. S. 204, 208 . . ."

To the same effect, see *Jackson* v. *Cravens*, 238 F. 117 (5th Cir. 1916); *Jackson* v. *Chicago, R. I. & P. Ry. Co.*, 178 F. 432 (8th Cir. 1910); cf. *Labor Board* v. *Drivers Local Union*, 362 U. S. 274, 291-292 (1960).

The anti-trust laws have been held inapplicable in other contexts when a more specialized remedy was provided. For example, the Court in *Terminal Warehouse* v. *Penn R. Co.*, 297 U. S. 500 (1936), held that a shipper had no action for damages under the anti-trust laws against a competitor and the railroad which had granted preferences to the competitor, but was limited to relief provided by the Interstate Commerce Act. Similarly, the anti-trust laws were held to be unavailing to a steamship line which sued its competitors, alleging a conspiracy to restrain trade. The Court held that the Shipping Act of 1916 provided a remedy which superseded the anti-trust laws. *United States Nav. Co.* v. *Cunard S. S. Co.*, 284 U. S. 474 (1932). Compare *S. S. W., Inc.* v. *Air Transport Ass'n of America*, 191 F. 2d 658, 663 (D. C. Cir. 1951), which succinctly summarized the law:

> "Where specific damage provisions are contained in regulatory statutes, it has been held that there may be no recovery of treble damages under the antitrust laws."

And see *Keogh* v. *C. & N. W. Ry. Co.*, 260 U. S. 156 (1992).[2]

The authorities relied upon by plaintiffs do not weaken this long line of authority. In *United States* v. *Borden Co.*, 308 U. S. 188 (1939), a criminal case holding that the anti-trust laws were not impliedly repealed by the Agricultural Marketing Agreement Act, the latter Act did not provide a damage remedy for the kind of conduct covered by the Sherman Act. See the *1955 Report of the Attorney General's Commission to Study the Anti-trust Laws*, at 282. Similarly, in *United States* v. *Philadelphia National Bank*, 374 U. S. 321 (1963), which held that the Bank Merger Act did not impliedly repeal the Clayton Act as it applied to bank mergers, the Court noted that the Bank Merger Act had no provision whatever for judicial proceedings and that the legislative history of that Act contained express statements to the effect that the applicability of the anti-trust laws was not affected. 374 U. S. at 351, 352.

Plaintiffs also point out that both the Securities Act of 1933[3] and the Securities Exchange Act of 1934[4] contain clauses pre-

2. Cases dealing with SEC or stock exchange rules or regulations allegedly violative of the anti-trust laws, see *Silver* v. *New York Stock Exchange*, 373 U. S. 341 (1963); *Kaplan* v. *Lehman Brothers*, 371 F. 2d 409 (7th Cir. 1967); *Baum* v. *Investors Diversified Services, Inc.*, 286 F. Supp. 914 (N. D. Ill. 1968), *aff'd.* 409 F. 2d 872 (7th Cir. 1969), would only be relevant if plaintiffs based their claim for relief on the pegging of prices which was lawful under Commission regulations, which could occur under section 9(a)(6) of the 1934 Act. The language of the complaint indicates, however, that plaintiffs rely on section 9(a)(2), an unqualified prohibition, rather than on section 9(a)(6).

3. "Sec. 16. The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity."

4. "Section 28. (a) The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this title

serving "rights and remedies that may exist at law or in equity." They argue that remedies under the Sherman and Clayton Acts, which pre-date the Securities Acts, are therefore saved by these provisions.

There are two primary difficulties with plaintiffs' arguments. First, it assumes that a remedy for stock market manipulation at one time existed under section 1 of the Sherman Act. Yet there are no cases to support this contention. And it appears that, at common law, a market manipulation scheme such as is here alleged constituted fraud and not common law restraint of trade. *Barret & Co.*, 9 S. E. C. 319, 328 (1941); *Halsey, Stuart & Co., Inc.*, 30 S. E. C. 106 (1949); Berle, Stock Market Manipulation, 38 *Col. L. R.* 393 (1938). Because the interpretation of "restraint of trade" in the Sherman Act is to be given the meaning it had at common law, *Apex Hosiery Co.* v. *Leader*, 310 U. S. 469, 498 (1940), the logical conclusion is that stock market manipulation schemes have never been within the coverage of the Sherman Act. And of course a non-existent remedy cannot be saved by the Securities Acts provisions cited above.

Moreover, as will be more fully discussed *infra*, the 1934 Act expressly limits recovery thereunder to actual damages, and the 1933 Act has been similarly construed. The language of the 1934 Act which limits damages is found immediately after the "saving clause" language,[5] indicating that only single damage remedies were to be preserved.[6] Thus, even if there once existed a Sherman Act cause of action for market manipulation, it was not saved by the later Securities Acts.

shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. . . ."

5. For the pertinent text, see note 4 supra.

6. See House Report 1383, accompanying H. R. 9323, 73rd Congress, Second Session, relating to what became section 28:

> "This subsection reserves rights and remedies existing outside of those provided in the Act, but limits the total amount recoverable to the amount of actual damages."

Finally, it is worth noting that a number of inconsistencies would result if plaintiffs were permitted to pursue both a Sherman Act and Securities Act cause of action. Beyond the differences in recoverable damages just referred to, there are significant differences in the governing statutes of limitation; compare section 13 of the 1933 Act and sections 9(e) and 18(c) of the 1934 Act with 15 U. S. C. 15b, and in the provisions for attorney's fees, compare section 9(e) of the 1934 Act with 15 U. S. C. § 15. These differences are substantial and would encourage investors to bring suit under the Sherman Act. Certainly Congress could not have intended that the damage restrictions contained in the carefully drawn prohibitions against market manipulation in the 1934 Act could be evaded and effectively nullified by the simple expedient of invoking the Sherman Act.

Count 3—Common Law Fraud.

Count 3 of the complaint incorporates the substantive allegations of count 1 but states that plaintiffs' right to recovery is based on common law fraud. Defendants' principal attack on this count is that, if counts 1 and 2 are dismissed, count 3 must also be dismissed since it contains no independent grounds of jurisdiction. Since this court has held, *supra*, that count 1 states a cause of action, defendants' contention is without merit. This court has pendent jurisdiction under the doctrine enunciated in *United Mine Workers* v. *Gibbs*, 383 U. S. 715, 725 (1966).

Certain defendants also claim that plaintiffs who have had no direct dealings with defendants will be unable to prove the elements of fraud necessary to permit recovery. The issues thus raised are factual, however, and cannot be resolved on the pleadings.

Motion to Dismiss Plaintiffs Robert and Sandra Schaefer.

The plaintiffs who initially filed this complaint are Robert and Sandra Schaefer. Since that time other named plaintiffs have been added by motion. Certain defendants have now moved to

dismiss the Schaefers from the complaint, claiming that they signed a covenant not to execute any judgment reached herein against certain defendants and that this instrument releases all defendants from liability to the Schaefers.

The Schaefers alleged in the complaint that they have suffered out of pocket losses of $4,572.99 in their dealings in Hercules Galion stock. The covenant not to execute, involving six defendants, states that the Schaefers have received $9,000 and that they therefore will not execute any judgment against these six parties. Although the covenant expressly states that no other defendants are thereby released, the law is clear that when the consideration for release from one defendant fully compensates the plaintiff for his alleged injury, all jointly liable defendants are also released. *Wagner* v. *C. & A. R. R. Co.*, 265 Ill. 245 (1914); *Husky Refining Co.* v. *Barnes*, 119 F. 2d 715 (5th Cir. 1941); *Rector* v. *Warner Bros. Pictures*, 102 F. Supp. 263 (S. D. Cal. 1952). The issue therefore becomes whether the $9,000 payment constituted full compensation to plaintiffs.

Under the Securities Acts, it is now authoritatively established that only actual, and not punitive, damages are recoverable. Section 28(a) of the 1934 Act so provides, see *Green* v. *Wolf Corporation*, 406 F. 2d 291 (2d Cir. 1968), *cert. den.* 395 U. S. 977, and the same limitation has been placed on the provisions of the 1933 Act by judicial interpretation. *Globus* v. *Law Research Services, Inc.*, 418 F. 2d 1276 (2d Cir. 1969); *Avern Trust* v. *Clarke*, 415 F. 2d 1238 (7th Cir. 1969). Moreover, "actual damages" under the Acts have been uniformly held to be limited to out of pocket losses, and do not include any speculative loss of profits. *Kohler* v. *Kohler Co.*, 208 F. Supp. 808, 825 (E. D. Wis. 1962), *aff'd.* 319 F. 2d 634 (7th Cir. 1963); *Estate Counseling Service, Inc.* v. *Merrill, Lynch, Pierce, Fenner & Smith*, 303 F. 2d 527, 533 (10th Cir. 1962); *Chaney* v. *Western States Title Insurance Company*, 292 F. Supp. 376 (D. Utah, 1968).

The Schaefers have received more than their out of pocket losses, measured by the difference between the allegedly inflated prices they paid for the securities in suit and the amount they received on their subsequent sale. Therefore, they have been fully compensated for damages sustained by the alleged violations of the Securities Acts, and count 1 must be dismissed as to them.

The Schaefers also seek punitive damages under the common law count. However, as previously noted, section 28(a) of the 1934 Act limits recovery to single damages. Although common law remedies are expressly preserved, the conclusion is unavoidable that common law damage rules permitting recovery in excess of actual damages have not been saved. Cf. *Meisel* v. *North Jersey Trust Company of Ridgewood, N. J.*, 216 F. Supp. 469 (S. D. N. Y. 1963). Because the 1933 and 1934 Acts are to be construed *in pari materia, Globus* v. *Law Research Service, Inc., supra,* at 1286, and cases cited therein, the result is that punitive damages may not be recovered under common law doctrines for conduct actionable under the Securities Acts counts. Therefore, having been fully compensated, the Schaefers must be dismissed from the complaint.

Motions to Dismiss Particular Defendants.

Defendant Peltz has alleged in his motion to dismiss that the complaint neither shows any causal connection between his actions and plaintiffs' injuries nor adequately charges that he was a participant in a conspiracy. But the complaint charges that Peltz, as a registered representative for Hertz, Warner & Co., agreed with the other defendants to artificially raise the price of the securities, received money from other defendants to induce their customers to buy Hercules Galion stock, and concealed these payments from buyers of this security. The complaint alleges an overall conspiracy and a number of overt acts —this is sufficient to withstand a motion to dismiss.

Peltz' causation argument amounts to a contention that no privity exists between himself and the plaintiffs. However, of the statutory provisions relied upon only § 12(2) expressly limits recovery to those in privity with the defendant. And the cases state that privity is not required for an action to be maintainable under Rule 10b-5. *Brennan* v. *Midwestern United Life Insurance Company,* 259 F. Supp. 673, 682-683 (N. D. Ind. 1966), and cases cited therein; *Geo. H. McFadden & Bro., Inc.* v. *Home-Stake Production Co.,* 295 F. Supp. 587 (N. D. Okla. 1968). Whether causation of these plaintiffs' injuries can be charged to Peltz, either alone or as part of a conspiracy, is a matter which must await trial for its resolution.

Defendants Morris and Eva Childs have also argued in support of their motion to dismiss that they are not sufficiently implicated by the charges made in the complaint. But they are charged with membership in the conspiracy, with transferring funds to other defendants to be used pursuant to an agreement to double the price of the stock, and with using funds borrowed from another defendant to purchase such securities. Whether the Childs were participants in the conspiracy, and whether these overt acts were innocent or culpable, are factual questions which cannot now be answered. The pleading as it stands, however, is sufficient to state a cause of action.

The First National Bank of Lincolnwood has moved to dismiss, contending that it cannot be held accountable for the criminal acts of its employees and directors. Along with the Bank, the chairman of its board of directors, two other directors and its president are also named as defendants. The Bank is named in the general conspiracy allegations of the complaint. Its officer and directors are charged with devising the scheme to inflate the price of Hercules Galion stock, and with taking various steps to implement it. The Bank is alleged to have loaned money to numerous principals in the conspiracy for the purpose of increasing the amount of trading in the securities.

Whether the Bank is chargeable as a principal participant in the conspiracy, whether it is liable on a theory of *respondeat superior* because of actual or apparent authority held by its employees and directors, or whether it will escape liability due to the nature of these individuals' alleged actions, are questions which involve the application of broad legal doctrines to the special facts of the case. See *Continental Baking Company* v. *United States*, 281 F. 2d 137, 149 (6th Cir. 1960); *Carroll* v. *First National Bank of Lincolnwood*, 413 F. 2d 353 (7th Cir. 1969); Fletcher, *Cyclopedia of the Law of Private Corporations* (1961), Vol. 10, p. 433; *Restatement of Agency Second*, § 219. The complaint on its face contains sufficient allegations to withstand the Bank's motion to dismiss.

Brokerage House Separate Defenses.

The court is grateful to the brokerage house defendants for presenting briefs, at its request, in support of their separate defenses. No motions are pending as to these issues. The court wishes only to point out that the questions of *respondeat superior* which are raised, and the questions relative to the extent of liability, if any, pursuant to the "controlling persons" provisions of the Securities Acts (section 15 of the 1933 Act and section 20(a) of the 1934 Act), are matters which must await further factual development for their resolution.

Conclusion.

For the reasons heretofore assigned, an order has been entered today dismissing count 2 in its entirety, dismissing plaintiffs Robert and Sandra Schaefer from the action, and denying all motions to dismiss in all other respects.

Enter:

BERNARD M. DECKER,
United States District Judge.

Dated: July 28, 1970.